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ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

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June 6, 2008

Karen Fields
Director, Pima Health Systems
3950 S. Country Club Way, Suite 400
Tucson, Arizona 85714

SUBJECT: AHCCCS Request for Proposal YH09-0001

Dear Ms Fields:

AHCCCS is in receipt of your bid protest, relative to the Request for Proposal (RFP) cited above, dated May 23, 2008. In your letter you state Pima Health System's (PHS) belief that the RFP and the resulting awards are out of compliance with multiple State and Federal regulations and laws.

Your protest is denied for several reasons.

I. The Protest was Untimely.

First, the protest was not filed within the time frames established by rule. Specifically, A.A.C. R9-22-604(D) requires that: allegations of improprieties that exist in the terms of the RFP must be filed before the due date for receipt of the proposal; allegations of improprieties that exist in the terms of an amendment to an RFP must be filed prior to the amended due date for receipt of proposals; and, in all other cases (such as allegations of improprieties in the scoring of the proposals), must be filed within ten days from when the protestor knew or should have known the basis of the protest.

The protest filed by PHS alleges that RFP no. YH09-0001 was defective because the RFP was amended to require offerors to submit proposed capitation rates based on data provided and the offeror's assessment of the cost to provide services to the average recipient. Although the protest does not explicitly state so, it appears clear that PHS is referring to Amendments 4 and 5 to RFP YH09-0001. Those amendments also established a due date of April 18, 2008, for the receipt of those portions of the proposals relevant to proposed capitation rates.

Pursuant to A.A.C. R9-22-604(D)(2) protests regarding the terms of these amendments were due by April 18, 2008. Without in any way granting any legitimacy to the substance of PHS' protest, the improprieties alleged by PHS were apparent from the terms of the amendments. The claim by PHS in its protest that it could not have known the "extent of harm" prior to the disclosure of the award, the scoring, and the actuarial certifications is not a relevant factor to determining timeliness if the alleged impropriety is contained in the RFP (or RFP amendment) itself. PHS, like all offerors, was required to provide an actuarial certification as part of its proposals. The improprieties your protest alleges should have been identified by PHS prior to the due date for

the receipt of proposals. Since the PHS protest was filed on May 23, 2008, that is, after the due date for the receipt of proposals, it was not filed in a timely fashion and, as a result, is denied.

AHCCCS is not required to address the merits of your protest because the protest was not filed in a timely manner. As a courtesy, and without waiving our position that the claim is untimely, the Administration will do so.

II. The Awards were Consistent with the Law and the Terms of the RFP.

In general response to the allegations in your protest, 1) the RFP and the final awards are not contrary to State or Federal statute or rule; 2) PHS provides no evidence of violations of due process or equal protection, and 3) the PHS protest makes a number of factual errors and incorrect conclusions. We will briefly address your specific allegations.

PHS Allegation: *"For many years, including this one, AHCCCS required offerors to base their capitation calculations on data actually experienced in the GSA and by the offeror, if applicable...AHCCCS substantially and arbitrarily changed this essential cornerstone of risk assessment and price calculation and required offerors to ignore actual data and instead base their responses on fictional, untested data designed to reflect the "average recipient"*

AHCCCS Response: Although some contractors may have based their rate requests on contractor specific data, AHCCCS has not in the past "required" offerors or contractors to base capitation calculations on contractor specific data. More importantly, the 2008 awards were based on the terms of the RFP, and as a result neither the contractors' nor the agency's past practices – whatever they may be – are relevant. In the current RFP process, neither the original RFP nor any amendments to the RFP instructed offerors to use contractor-specific data. To the contrary, AHCCCS repeatedly instructed offerors to use data in the RFP Bidders' Library, which includes actual experience data by GSA.. While it is irrelevant to this procurement, the methodology used by AHCCCS for developing the capitation rate ranges in this RFP is similar to past procurements. AHCCCS sets capitation rates based on average costs for the GSA (not individual contractors) using actual data provided by incumbent contractors.

The instruction to bid at the average allowed incumbent bidders who might have higher acuity populations to submit bids that would have a greater chance of falling within the AHCCCS-determined ranges. Even with the revised instructions, PHS' initial bid exceeded the ranges on 5 risk groups - the most of any bidder in the GSA, and reflected the greatest increase over current rates; at 11.4%, of any bidders in the GSA. PHS' initial bid received the lowest score of all nine bidders in GSA 10. The actuarial certification that accompanied the initial bid stated that, after risk adjustment, PHS would need a rate increase of 2.3% in aggregate to be paid an adequate rate. Thus the revised instructions arguably assisted PHS with the score you earned on the initial bid as we can assume your rates would have been approximately 2.3% greater, resulting in an even lower capitation score on the initial bid. PHS' accompanying actuarial certification was the only certification received of 12 bidders where the Actuary stated a qualification that the rates submitted are adequate assuming the rates are adjusted upward by a specific percentage. More discussion of the actuarial certifications follows on pages 5 and 6.

AHCCCS did not instruct bidders to use fictitious data or ignore actual data, but to use the data found in the Bidders' Library to bid at the average. The Bidders' Library contains thousands of data points collected from Contractors based on their contractual obligations. The encounter data used in the databook was tested against, and found to be well-supported by, incumbent plans' financial statements.¹

The *Data Supplement Instructions and Overview* in the Bidders' Library includes an introduction stating "this section of the bidder's library titled "Data Supplement" contains various utilization, cost, demographic, member month and financial information to aid in developing the capitation rate bids. This Data Supplement also contains databooks showing utilization and cost information for contract years '05...'06,...and the first six months of contract year '07...In addition to the data contained in this Data Supplement, AHCCCS actuaries compile data from a large variety of sources to determine actuarially sound rate ranges for the purposes of evaluating capitation rates. However, the data contained herein, especially the databooks, are **the cornerstone of capitation rate development**" (emphasis added). Thus bidders were advised from the start to rely on the data in the Data Supplement. A review of the three Question & Answer documents shows repeated responses from AHCCCS directing bidders back to the Data Supplement. The choice by PHS to use its own, limited data (if indeed that occurred) was your decision.

PHS Allegation: *"AHCCCS further frustrated the offerors' ability to provide accurate and sound pricing figures by announcing that whatever bid rates the offerors gave would be risk adjusted using an unknown risk adjustment model developed for other states whose managed care models differ materially from the model used in Arizona."*

AHCCCS Response: The amendments to which PHS objects resolve rather than create the issue identified by PHS. The original RFP at Section D, paragraph 53 stated that AHCCCS "anticipates utilizing an episodic/diagnostic risk adjustment methodology that will be applied to Contractor specific capitation rates for rates effective no sooner than April 1, 2009." Amendment 4 modified this language with, in relevant part, the following: "AHCCCS anticipates applying these risk factors by April 1, 2009 retroactively to the October 1, 2008, awarded capitation rates." To the extent that PHS alleges that an unknown risk adjustment made providing sound rates more difficult, the amendment, which indicated that the risk adjustment would be applied retroactively to the beginning date of the contract, moderates the impact of variations in the acuity of its particular enrollees.

That same amendment goes on to advise offerors that they can "factor in the anticipated impact of the Contractor's unique medical management and/or unit cost experience." Thus, while all of the offerors in the same GSA start with the same "average recipient," their proposed rates should have reflected the relative cost savings associated with the unique aspects of each offeror's

¹ PHS' own financial statement data is included in the Bidders' Library. Unfortunately PHS' encounter data is not included in the databooks, and in fact is the only incumbent contractor whose data was excluded. This exclusion was due to large gaps in encounter reporting by PHS, and was to the benefit of all bidders because, if PHS' limited data had been included, your data would have brought rates down for the entire GSA.

medical management and unit costs. To the extent that use of the average recipient's costs does not reflect a level of acuity unique to the contractor, that variation will be accounted for when the rates are amended to implement the risk adjustment methodology, and retroactive application of the risk adjustment methodology mitigates the offeror's risk from the variation.

Offerors were not expected to adjust the bid rates in anticipation of the risk adjustment methodology. Awardees will be required to provide an actuarial certification of the risk-adjusted capitation rates at the appropriate time and, consistent with federal requirements, any change in the reimbursement methodology would require AHCCCS to submit a new actuarial certification to CMS for its approval before the amendment was effective. See 42 CFR § 438.6(c) and 42 CFR 438.806. Because the risk adjustment model is (future) member specific, neither AHCCCS nor the bidders could know what any successful bidder's relative acuity will be. This was obvious on its face, and PHS should have filed a protest on this issue before the initial bids were submitted.

Finally, PHS appears to be making broad assumptions about the risk adjustment model. Since PHS does not know what model AHCCCS will employ, it is not clear how you determined any flaws in the model. To the best of our knowledge, none of the nationally accepted risk adjustment models is unique from state-to-state or payer-to-payer. Most importantly, although we will use a national model, we will be running the model using member-specific AHCCCS encounter data, not random or national data.

PHS Allegation: *"Naturally, the offerors were confused and posed sixty-eight questions of AHCCCS, including the reason for the sudden change. Unfortunately, AHCCCS did not respond to the questions posed of it until April 10, giving the offerors approximately a week to reformulate their pricing. Further, the answers provided by AHCCCS to many key questions were unresponsive. For example, when asked why there was a need to change the RFP, AHCCCS responded 'At this time, AHCCCS is not disclosing the reason for the amendment.'"*

AHCCCS Response: PHS' assertion that all of the offerors were "confused" lacks a factual basis. Of the 68 questions, exactly three were submitted by PHS; this does not suggest that PHS and its actuaries were befuddled by the revised bidding instructions. And the question you identify in your letter as "key" was not submitted by PHS. If PHS felt the instructions and timing were insufficient, this too is something it failed to timely protest.

PHS Allegation: *"Another example of AHCCCS' failure to follow their own rules is their failure to post the March 25, 2008 inquiry made by Southwest Catholic Health Network and the response thereto in the bidders' library as required by Section I Instructions (sic) to Bidders, paragraph 1 of the RFP."*

AHCCCS Response: Section I, paragraph 1 refers to bidders' inquiries received within a specified time frame and the process AHCCCS would allow and follow regarding those RFP questions. A bid protest is not an inquiry and therefore is not subject to the requirements found in this paragraph. In addition, there is no requirement in rule or regulation requiring AHCCCS to post bid protests or related responses.

PHS Allegation: *"One thing that was clear is that by requiring the offerors to utilize "average" data rather than actual data, AHCCCS was attempting to manipulate the pricing to result in lower rates. AHCCCS' strategy, in that regard, was successful. However, the true effect of these extraordinary changes and the manner in which they were administered, was the forced submission by the majority, if not all offerors, of actuarially (sic) questioned responses."*

AHCCCS Response: PHS fails to explain the basis for its incorrect assumption as to the agency's intent. Bidders were told repeatedly throughout the bid process to use the data made available at the outset of the RFP in the Bidders' Library. The Bidders' Library data is actual experience data for each GSA and used collectively does represent the average member.

As you now know, the reason for amendments three through five was the timely bid protest by Mercy Care Plan three days before the bids were initially due. In response to one of the concerns raised in that bid protest, AHCCCS instructed bidders to bid at the average of the GSA in an attempt to level the playing field for new bidders, and bidders with higher than average acuity. Obviously, new bidders do not have contractor specific data. Their proposed rates would have to be based on the average recipient in the GSA adjusted for the offeror's estimate of the impact of its unique medical management and unit cost. The amendment simply instructs all offerors to propose bids on the same basis.

PHS' statement about the majority of the actuarial statements is also erroneous. The clear majority (11 of 12) stated that the rates they bid were actuarially sound for an average Medicaid population. Seven of those 11 letters included a statement that they couldn't attest to what the risk adjustment factor would be and consequently they could not confirm that the future, risk-adjusted rates will be actuarially sound. This is an appropriate actuarial qualification; bidders were not being asked to attest to risk adjusted rates. The actuarial certification submitted by PHS was the *only* certification that did not state that the rates were adequate or actuarially sound for the average. (PHS' proposal was therefore in fact non-responsive.)

PHS Allegation: *"A review of the scoring data reveals that not only did AHCCCS encourage the submission of actuarially (sic) unsound responses, it actually rewarded those entities with the most unrealistic projections by giving greater weight to the initial responses rather than those derived as a result of the best and final offer period when the offerors had better, but still incomplete, information. AHCCCS' complete disregard of its requirement to select only actuarially (sic) sound proposals is evidenced by its answer to question #3 in its April 10 responses to offerors' questions "AHCCCS will allow qualification statements in the actuarial certification and the Offeror will not be evaluated negatively as a result." Clearly, actuarially (sic) unsound proposals are not responsive within the meaning of A.A.C. R9-22-603 and an award of a contract to an entity with an actuarially (sic) unsound plan is a violation of 42 C.F.R. §438.6."*

AHCCCS Response: AHCCCS did not encourage "unsound" responses. As discussed above, 11 of 12 actuarial certifications state that the bid rates are actuarially sound for the average population in the GSA, which is all that was required.

All bidders were informed via the original RFP that the initial bid received the greatest weight, and that there was no guarantee of a BFO, as stated in multiple sections, but most succinctly in Section I, paragraph 8: "AHCCCS reserves the right to accept any or all initial offers without

further negotiation and may choose not to request a best and final offer (BFO). Offerors are therefore advised to submit their most competitive offers at the outset." PHS' first bid should have been its most competitive bid. Since the original RFP explicitly stated that there was no guarantee of a second round of rate proposals this issue should have been raised in a protest filed before the due date for the receipt of proposals.

AHCCCS did not violate 42 C.F.R. §438.6. As noted, all of the proposals were accompanied by actuarial certifications of the soundness of the proposed rates – with the exception of PHS which did not receive an award. Consistent with the requirements of 42 CFR § 438.6, all of the accepted rates fall within a range of rates that have been developed in accordance with generally accepted actuarial principles and practices; are appropriate to the population in each GSA and to the services covered; have been certified by qualified actuaries engaged by the offerors and will be certified by AHCCCS' actuaries; and are based on utilization and cost data derived from the Arizona Medicaid populations for each GSA.

PHS Allegation: *"If AHCCCS and the entities to which it awards contracts as a result of this RFP are allowed to proceed using unsound financial plans, the people of Arizona can expect to see a result similar to that recently experienced in the finance industry. That is, the repeated failure of entity after entity because of fiscal irresponsibility. Awarding contracts based on fictional and flawed data and analysis is not in the best interest of the State and is contrary to the spirit of A.A.C. R9-22-603."*

AHCCCS Response: No fictional or flawed data was used to develop the Acute Care capitation rates – the rate ranges employed are based on actual utilization and cost data for the AHCCCS population in the GSA. PHS' prognostication of financial collapse is unsupported and unfounded.

PHS Allegation: *"The anticipated failure of entities who attempt to operate using pricing created for a nonexistent population will be accelerated and exacerbated by AHCCCS' insistence on the retroactive application of the risk adjustment formula at 80% rather than utilizing a phased-in application of risk adjustment. The experience documented in other states that utilize a risk adjustment model demonstrates that because of provider coding inconsistencies that arise during the first year of implementation, the process results in inaccurate risk scores which in turn directly effects and taints plan funding."*

AHCCCS Response: Amendment 4 to the RFP advises that a phased-in application of the risk adjustment will be employed consistent with the recommendations of published experts in this field: "the purpose of phase-in ...is to moderate the impact of the implementation of risk adjustment, both as MCOs refine data and understand the impact, but also as the state...[is] able to refine the risk adjustment process."² Winkelman and Damler define phase-in as "the portion of differences in risk adjustment which are applied to the MCO's capitation rate...If the **phase-in for a particular year were 80 percent** and the relative risk adjustment factor for a particular MCO was 0.95, then the phase-in risk adjustment factor for the MCO would be 0.96 [0.95 x 0.80 + 1.00 x .20]" (emphasis added).

² "Risk Adjustment in State Medicaid Programs," Winkelman, Ross and Rob Damler, *Health Watch*, January 2008

In addition to the explicit language in Amendment 4 to the RFP, PHS should have been aware that AHCCCS was planning to utilize a phased-in approach to risk adjustment. Slide 43 of the Bidders' Conference presentation, found in the Bidders' Library and presented at the February 11, 2008 Conference, states that AHCCCS will be using a phase-in provision. While the original RFP stated that AHCCCS would apply 50% of the risk adjustment (amended to 80%), both clearly identified the use of a two-year phase-in. To the extent PHS objected to the type of phase-in included in the RFP or the amended RFP, such a protest should have been filed prior to the due date for the receipt of proposals.

Conclusion

For the reasons stated above, your bid protest is denied. In accordance with A.A.C. R9-22-604 (I) you may file an appeal about the procurement officer's decision within five (5) days from the date the decision is received.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Veit", written in a cursive style.

Michael Veit
Contracts and Purchasing Officer